

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 03-36809

GOVERNOR'S CROSSING
OUTLET MALL, LLC

Debtor

**MEMORANDUM ON MOTION TO FIND
RENTS ARE NOT PROPERTY OF THE ESTATE**

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**RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE**

This contested matter is before the court on the Motion for the Entry of an Order Finding That Rents are Not Property of the Debtor's Estate (Rents Motion) filed on January 22, 2004, by Wells Fargo Bank Minnesota, N.A., (Wells Fargo), as Trustee for the registered holders of Morgan Stanley Capital I, Inc., Commercial Mortgage Pass-Through Certificates, Series 1999-FNV1.¹ Wells Fargo seeks an order by the court finding that rents collected by the Debtor are not property of the bankruptcy estate.

The facts and documents essential to the resolution of this issue are before the court on the Joint Stipulation filed by the parties on March 4, 2004, containing undisputed facts and eight exhibits, labeled A through H, on Wells Fargo's Motion and Legal Argument set forth therein, and on the Debtor's Memorandum in Support of Debtor's Response to Motion of Wells Fargo Bank Minnesota, N.A. for Determination Whether Lease Rents are Property of the Estate filed on March 11, 2004.²

This is a core proceeding. 28 U.S.C.A. § 157(b)(A) and (O) (West 1993).

¹ The Motion was joined with a Motion for an Order Pursuant to 11 U.S.C. §543(d)(1) to Excuse Custodian From the Requirements of 11 U.S.C. §543(a). The § 543(d)(1) issue is set for trial on April 19, 2004, together with the Motion of Wells Fargo for Relief From the Automatic Stay filed by Wells Fargo on January 23, 2004.

² The parties recite in the first paragraph of the Joint Stipulation that the stipulation is entered into "regarding the Motion of Wells Fargo for Relief From the Automatic Stay" filed by Wells Fargo on January 23, 2004. The Debtor acknowledges in its March 11, 2004 Memorandum that the Joint Stipulation, in fact, pertains to the Rents Motion presently before the court.

I

On December 24, 1998, the Debtor executed a Promissory Note (Note) in favor of Finova Realty Capital, Inc., in the amount of \$9,700,000.00. Ex. A. The parties also entered into an Assignment of Leases and Rents (Assignment of Rents) dated December 24, 1998. Ex. E. The Note was secured by a Deed of Trust and Security Agreement (Deed of Trust) dated December 24, 1998, and by a UCC-1 Fixture Filing (Fixture Filing). Exs. B and C. The Assignment of Rents, Deed of Trust, and Fixture Filing were all duly recorded on December 31, 1998, with the Register of Deeds for Sevier County, Tennessee. Pursuant to the Deed of Trust, the Debtor pledged as collateral the real property, improvements, easements, fixtures and personal property, leases and rents, insurance proceeds, condemnation awards, tax certiorari, licenses, intangibles, and other rights relating to the Governor's Crossing Outlet Mall (the Mall) located in Sevier County, Tennessee.

On August 2, 1999, Finova Realty Capital, Inc., recorded a UCC-3 Assignment with the Register of Deeds for Sevier County, Tennessee, assigning the Fixture Filing to Norwest Bank Minnesota, N.A., which has since been purchased by Wells Fargo. Ex. D. Additionally, on August 2, 1999, Finova Realty Capital, Inc., recorded an Assignment of Deed of Trust and Security Agreement in favor of Norwest with the Register of Deeds for Sevier County, Tennessee. Ex. F. Morgan Stanley Capital I, Inc., Commercial Mortgage Pass-Through Certificates, Series 1999-FNZ1 (Morgan Stanley) is the current holder of the Note, and Wells Fargo, as Trustee for Morgan Stanley, is authorized to proceed in this action.

The Debtor defaulted under the terms of the Note. Accordingly, on November 10, 2003, Wells Fargo gave the Debtor written notice that it was accelerating the balance due under the Note and demanding payment in the aggregate amount of \$10,005,927.14 no later than November 13, 2003. Ex. G. The Debtor did not pay the accelerated balance, and on November 24, 2003, Wells Fargo filed a Sworn Complaint for Receiver, initiating Case No. 03-11-576 in the Chancery Court for Sevier County, Tennessee. Pursuant to Wells Fargo's Complaint, the Chancery Court entered an Ex Parte Order of Appointment of Receiver on November 24, 2003, whereby John Cheadle was appointed receiver (Receiver). Ex. H. Pursuant to this Order, the Debtor was required to turn over possession of all of the Mall's assets, including its books and accounts, and the Receiver was authorized to "collect all rent payments, funds and accounts receivable" and to pay all operating costs of the Debtor. Ex. H.

The Debtor filed the Voluntary Petition commencing its Chapter 11 bankruptcy case on December 16, 2003. Also on December 16, 2003, the Debtor served a letter upon the Receiver demanding that he surrender the Debtor's assets pursuant to 11 U.S.C.A. § 543(a) (West 1993) and for an accounting pursuant to 11 U.S.C.A. § 543(b) (West 1993). Wells Fargo opposes these requests, which have been scheduled for hearing on March 24, 2004.

II

The issue presently before the court is whether the rents in the Receiver's possession are property of the Debtor's bankruptcy estate. "Property of the estate includes 'all legal or

equitable interests of the debtor in property as of the commencement of the case' and '[p]roceeds, product, offspring, rents, or profits of or from property of the estate” *In re Kingsport Ventures, L.P.*, 251 B.R. 841, 846 (Bankr. E.D. Tenn. 2000) (quoting 11 U.S.C.A. § 541(a)(1), (6)) (emphasis added). However, even though rents are theoretically property of a debtor’s estate, if the debtor has executed an absolute assignment of rents in favor of another party, the subject rents are not property of the estate. *Kingsport Ventures*, 251 B.R. at 848-49.

In order to determine if the Assignment of Rents was an absolute assignment or the granting of a security interest, the court “must analyze the language and provisions of the assignment.” *Kingsport Ventures*, 251 B.R. at 847. Even if the document itself states that it is an absolute assignment, if statements within the document evidence that it was, in fact, the parties’ intent that the assignment serve as the pledge of a security interest, those statements will control, and the rents will be considered property of the bankruptcy estate. *Kingsport Ventures*, 251 B.R. at 847. On the other hand, if the document clearly evidences that the parties intended to create an absolute assignment, the debtor will not have any residual interest in the rents in question. *Kingsport Ventures*, 251 B.R. at 847-48.

In this case, the Assignment of Rents reads, in part:

Section 1.1 Property Assigned. Borrower hereby absolutely and unconditionally assigns and grants to Lender the following property, rights, interests and estates, now owned, or hereafter acquired by Borrower:

....

(c) Rents. All rents, additional rents, revenues, income, issues and profits arising from the Leases and renewals and replacements thereof and any cash or security deposited in connection therewith and together with all rents, revenues, income, issues and profits (including all oil and gas or other mineral royalties and bonuses) from the use, enjoyment and occupancy of the Property, whether paid or accruing before or after the filing by or against Borrower of any petition for relief under the Bankruptcy Code (collectively, the "Rents").

....

Section 1.3 Termination of Assignment. Upon payment in full of the Debt and the delivery and recording of a satisfaction or discharge of Security Instrument duly executed by Lender, this Assignment shall become null and void and shall be of no further force and effect.

....

Section 2.1 Present Assignment and License Back. It is intended by Borrower that this Assignment constitute a present, absolute assignment of the Leases, Rents, Lease Guaranties and Bankruptcy Claims, and not an assignment for additional security only. Nevertheless, subject to the terms of this Section 2.1, Lender grants to Borrower a revocable license to collect and receive the Rents and other sums due under Leases and the Lease Guaranties. Borrower shall hold the Rents and all sums received pursuant to any Lease or Lease Guaranty, or a portion thereof sufficient to discharge all current sums due on the Debt, in trust for the benefit of Lender for use in the payment of such sums.

....

Section 3.1 Remedies of Lender. Upon or at any time after the occurrence of a default under this Assignment or an Event of Default (as defined in the Security Instrument) (a "Default"), the license granted to Borrower in Section 2.1 of this Assignment shall automatically be revoked, and Lender shall immediately be entitled to possession of all Rents and sums due under any Lease or Lease Guaranties, whether or not Lender enters upon or takes control of the Property. In addition, Lender may, at its option, without waiving such Default, without notice and without regard to the adequacy of the security for the Debt, either in person or by agent, nominee or attorney, with or without bringing any action or proceeding, or by a receiver appointed by a court, dispossess Borrower and its agents and servants from the Property, without liability for trespass, damages or otherwise and exclude Borrower and its agents or servants wholly therefrom, and take possession of the Property and all

books, records and accounts relating thereto and have, hold, manage, lease and operate the Property on such terms and for such period of time as Lender may deem proper and either with or without taking possession of the Property in its own name, demand, sue for or otherwise collect and receive all Rents and sums due under all Leases and Lease Guaranties, including those past due and unpaid with full power to make from time to time all alterations, renovations, repairs or replacements thereto or thereof as may seem proper to Lender and may apply the Rents and sums received pursuant to any Lease or Lease Guaranties to the payment of the following in such order and proportion as Lender in its sole discretion may determine, any law, custom or use to the contrary notwithstanding: (a) all expenses of managing and securing the Property, including, without being limited thereto, the salaries, fees and wages of a managing agent and such other employees or agents as Lender may deem necessary or desirable and all expenses of operating and maintaining the Property, including, without being limited thereto, all taxes, charges, claims, assessments, water charges, sewer rents and any other liens, and premiums for all insurance which Lender may deem necessary or desirable, and the cost of all alterations, renovations, repairs or replacements, and all expenses incident to taking and retaining possession of the Property; and (b) the Debt, together with all costs and reasonable attorneys' fees. In addition, upon the occurrence of a Default, Lender, at its option, may (1) complete any construction on the Property in such manner and form as Lender deems advisable, (2) exercise all rights and powers of Borrower, including, without limitation, the right to negotiate, execute, cancel, enforce or modify Leases, obtain and evict tenants, and demand, sue for, collect and receive all Rents from the Property and all sums due under any Lease or Lease Guaranties, (3) either require Borrower to pay monthly in advance to Lender, or any receiver appointed to collect the Rents, the fair and reasonable rental value for the use and occupancy of such part of the Property as may be in possession of Borrower or (4) require Borrower to vacate and surrender possession of the Property to Lender or to such receiver and, in default thereof, Borrower may be evicted by summary proceedings or otherwise.

....

Section 5.7 Choice of Law. This Assignment shall be governed, construed, applied and enforced in accordance with the laws of the state in which the Property is located.

Ex. E. Although the Debtor offers arguments to the contrary, based upon the clear and unambiguous language of the Assignment of Rents, it is apparent that this was an absolute assignment, and thus, the rents in question are not property of the Debtor's estate.

The facts of this case are similar to those addressed by the court in *Kingsport Ventures*, in which that debtor executed an assignment of its interests in motel revenues in connection with the execution of a promissory note to the creditor bank. The *Kingsport Ventures* assignment, like the one at issue in this case, also granted the debtor a license to collect and use the revenues until such time as the debtor defaulted under the terms of the note, which the debtor did pre-petition. Moreover, the material paragraphs of the *Kingsport Ventures* assignment cited by the court are almost verbatim to those referenced above with these providing even more detail. See *Kingsport Ventures*, 251 B.R. at 844.

In order to determine if the *Kingsport Ventures* assignment was absolute, thereby divesting the debtor of any interest in the property, or merely the grant of a security interest, the court closely examined the terms of the assignment as a whole under Tennessee contract law. The court noted, first, that “the language of the Assignment is clear and unambiguous in its statement that it was ‘intended by Assignor that this assignment constitutes a present, absolute and unconditional assignment and not an assignment for additional security only.’” *Kingsport Ventures*, 251 B.R. at 848. Second, pursuant to the assignment, the debtor only retained “a revocable license to operate the motel property and collect the rents.” *Kingsport Ventures*, 251 B.R. at 848. Third, in the event of default, under the assignment, the assignee

was not required “to take any action in order to collect the rents.” *Kingsport Ventures*, 251 B.R. at 848. Fourth, after default, the assignment gave the assignee “total discretion regarding the application of rents collected by it . . . to reduce the [d]ebtor’s outstanding obligation.” *Kingsport Ventures*, 251 B.R. at 848. Noting that testimony to the contrary did not change the result, the court found that it “must enforce the Assignment as it is written, thus it must look to the intent as it is embodied in the contract rather than the state of mind of the party executing the contract.” *Kingsport Ventures*, 251 B.R. at 848.

In this case, the court must once again look at the clear, unambiguous terms of the Assignment of Rents, regardless of any arguments by the Debtor that its intentions were to the contrary. Section 2.1 of the Assignment of Rents states that “[i]t is intended by Borrower that this Assignment constitute a present, absolute assignment of the Leases, Rents, Lease Guaranties and Bankruptcy Claims, and not an assignment for additional security only.” Ex. E. Likewise, that same section grants the Debtor only a revocable license to collect and hold the rents, in trust, for the benefit of the Lender. Ex. E. Additionally, under Section 3.1, the Lender does not have to do anything to be entitled to the rents upon the Debtor’s default. Finally, Section 3.1 also gives the Lender the sole discretion regarding whether to credit the rents towards the debt.

The Debtor urges the court to take all of the statements in the various documents as proof that it intended for the Assignment of Rents to be merely the grant of a security interest and not an absolute assignment. In support of this argument, the Debtor first refers to the Note itself. Article 7 of the Note, entitled SECURITY, provides, as follows:

This Note is secured by that certain Deed of Trust and Security Agreement dated the date hereof in the principal sum of \$9,700,000.00 given by Borrower to (or for the benefit of) Lender covering the fee estate of Borrower in certain premises located in Sevier County, State of Tennessee, and other property, as more particularly described therein (collectively, the "Property") and intended to be duly recorded in said County (the "Security Instrument"), and by the Other Security Documents.

Ex. A. As pointed out by the Debtor, there are no direct references to the Assignment of Rents in the Note itself.

The Debtor also relies upon the fact that the Deed of Trust, in ARTICLE I - GRANTS OF SECURITY, expressly provides that leases and rents are security for the Note, as follows:

(f) Leases and Rents. All leases, subleases and other agreements affecting the use, enjoyment or occupancy of the Land and/or the Improvements heretofore or hereafter entered into and all extensions, amendments and modifications thereto, whether before or after the filing by or against Borrower of any petition for relief under 11 U.S.C. § 101 et seq., as the same may be amended from time to time (the "Bankruptcy Code") (the "Leases") and all right, title and interest of Borrower, its successors and assigns therein and thereunder, including, without limitation, any guaranties of the lessees' obligations thereunder, cash or securities deposited thereunder to secure the performance by the lessees of their obligations thereunder and all rents, additional rents, revenues, issues and profits (including all oil and gas or other mineral royalties and bonuses) from the Land and the Improvements whether paid or accruing before or after the filing by or against Borrower of any petition for relief under the Bankruptcy Code (the "Rents") and all proceeds from the sale or other disposition of the Leases and the right to receive and apply all Rents to the payment of the Debt[.]

Ex. B.

Nevertheless, Section 1.2 of the Deed of Trust negates that argument:

Section 1.2 Assignment of Leases and Rents. Borrower hereby absolutely and unconditionally assigns to Lender and Trustee Borrower's right, title and interest in and to all current and future Leases and Rents; it being intended by Borrower that this assignment constitutes a present, absolute assignment and not an assignment for additional security only. Nevertheless, subject to the terms of this Section 1.2 and Section 3.8, Lender grants to Borrower a revocable license to collect and receive the Rents. Borrower shall hold a portion of the Rents sufficient to discharge all current sums due on the Debt for use in the payment of such sums.

Ex. B. Section 3.8 of the Deed of Trust only allows the Debtor to enter into leases with third parties for spaces within the Mall, without obtaining prior written consent of the Lender, as long as it does not have a materially adverse effect on the Mall property, as a whole, or it does not involve a party that leases more than 5% of the Mall property. Ex. B.

The Assignment of Rents executed by the Debtor on December 24, 1998, was an absolute assignment. Accordingly, as of that date, "[the Debtor] had no legal right to that property[, and any] equitable right that it may have in the property is subordinate to and cannot be asserted against [Wells Fargo] until its debt to [Wells Fargo] is satisfied." *Kingsport Ventures*, 251 B.R. at 849. Since the Debtor has no legal or equitable interest in the rents, these rents are not property of the estate.³

³ Because the court finds that the Assignment of Rents, in connection with the Note and Deed of Trust, is absolute, the court will not address the parties' secondary argument that the rents cannot be property of the bankruptcy estate because they are in the Receiver's possession.

An order consistent with this Memorandum will be entered.

FILED: March 22, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 03-36809

GOVERNOR'S CROSSING
OUTLET MALL, LLC

Debtor

ORDER

For the reasons stated in the Memorandum on Motion to Find Rents are Not Property of the Estate filed this date, the court directs the following:

1. The Motion for the Entry of an Order Finding That Rents are Not Property of the Debtor's Estate filed January 22, 2004, by Wells Fargo Bank Minnesota, N.A., as Trustee for the registered holders of Morgan Stanley Capital I, Inc., Commercial Mortgage Pass-Through Certificates, Series 1999-FNVI, is GRANTED.

2. The rents associated with the Debtor's operation of the Governor's Crossing Outlet Mall in Sevier County, Tennessee, are not property of the bankruptcy estate but are the property of Wells Fargo Bank Minnesota, N.A., as Trustee for the registered holders of Morgan Stanley Capital I, Inc., Commercial Mortgage Pass-Through Certificates, Series 1999-FNVI.

SO ORDERED.

ENTER: March 22, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE